STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

ILLINOIS COMMERCE COMMISSION	)	
On Its Own Motion	)	
	)	
vs.	)	
	)	
	)	**Docket 00-0714**
ILLINOIS POWER COMPANY	)	
	)	
Reconciliation of revenues collected under	)	
gas adjustment charges with actual costs	)	
prudently incurred.	)	

ILLINOIS POWER COMPANY'S REPLY BRIEF

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I. INTRODUCTION

Staff's Initial Brief provides no persuasive support for the disallowances to Illinois Power Company's ("Illinois Power", "IP", or "Company") gas costs that Staff has proposed. Staff's proposed disallowances remain unjustified, and must be rejected.

This Reply Brief is organized in a manner corresponding to the organization of the "Argument" section of Staff's Initial Brief.

II. ILLINOIS POWER DECISION MAKING PROCESS (Response to §III. A-B of Staff's Initial Brief)

Staff asserts that in deciding to retire the Freeburg propane plant and the Gillespie Storage Field, Illinois Power "failed to consider all relevant information pertaining to the issues at hand." (Staff Rep. Br., pp. 2-3) Staff's assertion is based on the fact that in retiring the Freeburg and Gillespie facilities, IP did not conduct present value of future revenue requirements ("PVRR") analyses comparing the PVRR to cancel the facility and use other options to replace its capacity, versus the PVRR of making necessary capital expenditures on the facility and continuing to operate it for another 15 to 30 years. (See Id., pp. 4-6) Despite Staff's focus on the lack of a PVRR analysis at the time of retirement, the record in this case shows that retirement of these two facilities are appropriate decisions in light of all relevant factors.

As described in §II of IP's Initial Brief, Illinois Power retired the Freeburg propane plant because of concerns about the safety and reliability of this 30-year-old facility, including the costs that would be required to maintain safety and reliability. While IP did not at that time conduct studies in the form presented in this case, the PVRR studies that were presented in this docket show that retirement of Freeburg was the appropriate choice. Similarly, as described in §III of IP's Initial Brief, Illinois Power

retired the 42-year old Gillespie Storage Field based on the amount of capital expenditures that were needed to renovate the compressor station at the Field, the small size of the Field, and certain operational concerns. Again, while IP did not conduct PVRR studies at the time of retirement, the PVRR studies presented in this case show that retirement of the Gillespie Field was the appropriate decision.

It is Staff, not IP, that "failed to consider all relevant information pertaining to the issues at hand." Staff presented PVRR analyses that omitted important costs associated with continuing to operate Freeburg and Gillespie, such as the costs of maintaining the propane and gas inventories which these facilities need in order to operate, and the costs for future capital improvements and upgrades that will be needed if, as Staff asserts, these facilities should be operated for 30 more years. Staff acknowledges in its Initial Brief that its PVRR analyses were deficient with respect to a number of assumptions. (See, e.g., pp. 8, 11-12, 13, 25) Staff also based its PVRR analyses on overstated costs for replacement pipeline firm transportation ("FT") capacity; Staff in effect treated the winter-peaking Freeburg propane plant and Gillespie Storage Field as though they were year-round supply facilities, and thus seriously overstated the costs to replace these facilities. Just this one erroneous assumption, when corrected, is enough to change the purported PVRR advantage for continued operation of these facilities to a PVRR advantage for retirement.

Staff's assertions that the fact that IP did not conduct PVRR analyses at the time of retirement of these facilities "is a major change from past IP activity before the Commission" and that "use of PVRR analyses to justify why a certain decision is best versus other alternatives is the industry practice before the Commission," are wrong.

(Staff Init. Br., pp. 4-5) Staff's assertions are based on one example, the certificate application for IP's Hillsboro Storage Field and the introduction of that facility into rate base. (Id.) Presentation of a PVRR analysis in requesting a certificate for a new facility is required, implicitly if not expressly, by §8-406(b) of the Public Utilities Act (220 ILCS 5/8-406(b)) regarding applications for certificates of public convenience and necessity for construction of new facilities.[1] Use of PVRR analyses was also a requirement of the Commission's now-defunct least-cost planning rules (also cited by Staff at page 5 of its Initial Brief) under now–repealed §8-402 of the Act.[2] However, while use of PVRR analyses may be required to demonstrate that construction of a new facility for which a certificate is sought is "least cost", and may have been required to demonstrate that a resource plan was "least cost" (prior to repeal of §8-402), "least cost" is not a requirement found in §9-220(a) of the Act, which controls recovery of costs through fuel and gas adjustment clauses (notwithstanding Staff's attempt to suggest otherwise at page 3 of its Initial Brief).[3] It is also not a requirement found in 83 Ill. Adm. Code 525, the Commission's regulation on purchased gas adjustment clauses.

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[1] "The Commission shall determine that proposed construction will promote the public convenience and necessity only if the utility demonstrates: (1) that the proposed construction is necessary to provide adequate, reliable and efficient service to its customers and is the least-cost means of satisfying the service needs of its customers. . . ." (emphasis added).

[2] 83 Ill. Adm. Code Parts 440 and 535 (repealed). See, e.g., Parts 440.310(a)(4) and 440.620(c).

[3] There is one exception to the statement that "least-cost" is not a requirement of §9-220(a) for recovery of fuel and gas costs through automatic adjustment charges: "lowest cost" is a requirement for recovery of certain coal transportation costs through a fuel adjustment charge. The General Assembly has chosen to apply this requirement to recovery of certain coal transportation costs, and not to any other aspect of recovery of fuel or gas costs through fuel or gas adjustment clauses.

Indeed, the very order cited by Staff, Docket 93-0183, disproves Staff's assertion that "use of PVRR analyses to justify why a certain decision is best versus other alternatives is the industry practice before the Commission." In that Order, immediately following its discussion of the Hillsboro Storage Field, the Commission discussed and admitted to gas rate base eight other new capital projects, only one of which IP justified by a PVRR analysis. (Each of these eight projects involved a larger capital expenditure than the capital expenditures that would have been required in 2000 to continue to operate the Freeburg or Gillespie facilities.) The Commission expressly found all eight of these capital projects to be prudent and reasonable.[4] (See Order in Docket 93-0183 (Apr. 6, 1994), pp. 12-18) Later in that Order, in discussing another capital project that Staff contended should not be allowed in rate base, the Commission rejected just the sort of "must be based on PVRR" argument that Staff is relying on in this docket. The following language from that Order is no less applicable today:

> ***Staff witness Lounsberry*** proposed that the costs of the construction tracking feature and the marketing and expanded services feature be excluded from rate base. ***In proposing their exclusion, Staff emphasizes that the Company has not shown that the benefits of these features outweigh the costs to ratepayers*** (Initial Brief, pp. 60-61). Staff notes that the IP witnesses testified that the quantified "savings" for the construction and tracking feature would not cause O&M expense reductions. Staff indicates that IP should be required to demonstrate that this feature provides actual cost reductions to ratepayers. Staff states that while this feature may cause an immediate benefit to IP, this is not an adequate basis for recovery of its cost from ratepayers. Staff concludes that IP has not shown how this feature provides needed benefit to customers.

[4] In its initial delivery services rate case, Dockets 99-0120 & 99-0134 (Cons.), which is the only order setting a revenue requirement for IP subsequent to Dockets 91-0147 and 93-0183, the Company submitted evidence describing major additions to its distribution facilities since 1992, but did not submit PVRR analyses in support of its decisions to construct any of these facilities. No party, including Staff, contended that IP should have conducted or submitted PVRR analyses to justify these projects.

> Similarly, Staff asserts that IP has failed to show how the marketing and expanded services feature provides benefits to ratepayers. Staff indicates that IP witnesses made an unsubstantiated statement that this feature would enhance customer service. Staff asserts that IP failed to show that its customers desire or need the specific information available from this feature.
>
> In response, the Company indicates that Staff's proposed standard, a strict cost/benefit test, is not appropriate for these two features. ***IP emphasizes that its decision to implement CIS was not based on a strict cost/benefit analysis which compared its costs to explicit O & M expense savings that it would produce***. IP indicates that such a test would fail to account for the non-quantifiable, intangible benefits that drove it to implement CIS.
>
> IP also asserts that its evidence establishes that both of these features will provide benefits to customers. IP concludes that these two features, like the overall CIS project, are justified based on their overall benefits, including improved service to customers.
>
> The Commission concludes that the costs of the construction tracking feature and the marketing and expanded services feature should be included in rate base. ***Staff's strict cost/benefit test for these features is an inappropriate standard that is not found in the Public Utilities Act***. The Company's evidence concerning the increased efficiency and the improved customer service that would result from these features justifies the inclusion of the costs of these features in rate base. (Order in Docket 93-0183, pp. 24-25; emphasis added)[5]

As was the case in Dockets 91-0147 and 93-0183, Staff's analysis in this docket gives insufficient weight to other important factors that must be considered in evaluating whether is was worthwhile to pour additional capital dollars into the Freeburg and

[5] The Commission had earlier rejected a similar argument by Staff in an IP electric rate case, Docket 91-0147, in allowing the $10.7 million "BFMS" project into rate base. Staff contended that the BFMS project should not be allowed in rate base because "IP has failed to present evidence that BFMS provides a net economic benefit to ratepayers." (Order in Docket 91-0147 (Feb. 11, 1992), p. 43) The Commission, however, concluded that "While Staff proposes that a proper, net present value economic benefits test pertaining to BFMS should have been performed by IP, the Commission cannot conclude that failure to perform such a test is a sufficient basis for excluding BFMS from rate base. Therefore, Staff's proposed adjustment is rejected." (Id., p. 48)

Gillespie facilities in order to continue to operate them.[6] Staff dismisses the pressure-related operational concerns relating to the Gillespie Field and the safety issues relating to the Freeburg plant, as well as the Company's concerns about continuing to bear the liability risk associated with the Freeburg facility (see Staff Init. Br., p. 18). Staff's view of the Freeburg safety concerns essentially amounts to, "if nothing happened in the last 30 years, nothing should happen in the next 30 years". But it is Illinois Power that would be exposed to liability for any accident at the Freeburg facility, not Staff. Staff also ignores the greater convenience, safety and flexibility provided by pipeline FT as a capacity source as compared to the propane plant.

As the foregoing discussion of the orders in Dockets 91-0147 and 93-0183 shows, Illinois Power's lack of PVRR analyses in deciding to retire the Freeburg and Gillespie facilities is not "a major change from past IP activity before the Commission" nor at variance with "practice before the Commission." In fact, it is Staff's positions in this case that are a "change from past [Staff] activity before the Commission." As shown in IP's Initial Brief (p. 28), Staff's assertion that IP's practice of selecting firm supply reservation contracts based solely on lowest reservation costs is imprudent, is directly contrary to Staff's witness Lounsberry's acceptance of the same practice in ***last year's reconciliation case***. With respect to the lack of PVRR analysis in deciding to retire the Freeburg plant, IP previously retired its other four propane plants without (so far as the relevant reconciliation orders show) the presentation of a PVRR analysis to justify the

[6] Even in the by-gone days of statutory "least-cost planning", PVRR analyses were not the be-all and end-all of decisionmaking. For example, the Commission's order in Docket 91-0024 (cited by Staff at p. 5 of its Initial Brief), in discussing the Hillsboro Storage Field project, states that "Illinois Power also identified benefits of the Hillsboro Project which are not captured by economic analysis", and describes those benefits. (Order in Docket 91-0024 (Sept. 2, 1992), p. 43)

decision, or a hint of objection from Staff.[7] In fact, the reconciliation order for 1994, the year in which the first two propane plants were retired, discloses that:

> ***Mr. Eric Lounsberry***, now of the Energy Division of the Commission, testified that based on Staff's review of IP's filings in this docket and of the Company's responses to extensive data requests, Staff found no reason to dispute the Company's position that its gas supplies were prudently purchased. He testified that his review included the Company's responses to Planning and Operations Department data requests which were admitted in evidence as IP Group Exhibits POD 2 and POD CONF. (Order in Docket 95-0122, p. 3; emphasis added; citations omitted)

Illinois Power agrees that prudence is about taking appropriate factors into account in making decisions, which the evidence shows IP did with respect to the decisions at issue in this case. However, prudence is also about adhering to an established, identifiable set of standards and expectations. For Staff (or the Commission) to accept a decision (and a decisionmaking process) and the resulting costs as prudent in one case, and then claim the same process is "imprudent" in a later case, leaves the utility to play a guessing game, and would not represent consistent and responsible regulation. It is distressing that in its efforts to support disallowances in IP's 2000 gas costs, Staff deviated so drastically from positions it had previously taken regarding the same fact situations, and advocated a position that was previously rejected by the Commission.

What is perhaps most short-sighted and deficient about Staff's positions on Freeburg and Gillespie, however, is that Staff concludes the Company should invest substantial dollars to continue operating these aging facilities, based on a set of mathematical exercises whose results are dependent on the accuracy of key assumptions

[7] IP retired two propane plants in 1994, one in 1995 and one in 1996. (Rev. IP Ex. 3.5, pp. 4-5) The reconciliation orders for those years are Dockets 95-0122 (Dec. 9, 1998), 96-0035 (Dec. 9, 1998), and 97-0018 (Nov. 5, 1998).

over the next 15 to 30 years. Such reliance on PVRR analyses is particularly problematic where, as in this case, reasonable changes in the assumptions used result in changes in the PVRR conclusion, and there are also significant, hard to quantify factors involved. Staff's proposed disallowances must be rejected.

III. RETIREMENT OF FREEBURG PROPANE FACILITY (Response to §III.C of Staff's Initial Brief)

As shown in §II.A and B of Illinois Power's Initial Brief, the evidence presented in this case establishes that retirement of the Freeburg propane plant was an appropriate and prudent decision. Staff has not advanced any arguments in §III.C of its Initial Brief that support its proposed disallowance.

At the outset of this discussion Illinois Power notes another area in which Staff, not the Company, seeks to implement a "major change" and to depart from "industry practice" in reconciliation cases before the Commission: Staff treats certain of IP's answers to data requests as though they were the Company's direct testimony. (See, e.g., Staff Init. Br., pp. 6-7, 15, 21) IP's data request responses were not, of course, evidence at the time submitted to Staff. Rather, this case followed the procedure that has been consistently followed in reconciliation cases before the Commission: The utility submitted direct testimony in response to the Initiating Order that showed its gas costs and revenues for the reconciliation year, and described its gas procurement practices. Staff then conducted an extensive investigation through data requests before filing its direct testimony.[8] During the discovery phase, Staff is not required to reveal what actions

[8] Mr. Lounsberry, the Staff Engineering Department representative assigned to determine if IP's gas purchasing decisions during the reconciliation period were prudent (Staff Ex. 2.0, pp. 1-2), propounded 197 data requests to IP in this case. (Tr. 58) This total does not include the data requests propounded by the Staff Accounting Department.

or decisions it may consider imprudent. Only upon filing its direct testimony was Staff required to identify the specific areas in which it believed IP may have acted imprudently. At that point, IP was called upon to respond to Staff's specific areas of concern with evidence, which it did in its rebuttal filing. IP's rebuttal evidence resolved some of Staff's concerns (see Staff Ex. 4.0, pp. 20, 23, 25) but not others, as to which Staff provided further elaboration in its rebuttal testimony. The Company responded to Staff's further points in its surrebuttal testimony. This is the procedure that has been followed in innumerable reconciliation cases to litigate prudence issues. It is also the procedure approved by the Illinois courts for cases in which a utility seeks to recover costs through its rates and specific elements of those costs are challenged as imprudent:

> The People's argument is based entirely on the erroneous assumption that a utility has the burden of going forward on any and all issues which are conceivably relevant to the reasonableness of its proposed rates. This premise is directly contrary to the overwhelming weight of authority and would place an impossible burden on the utility of anticipating the basis of every intervenor's objection and of coming forward with evidence during its case in chief with respect to each objection.
>
> Once a utility makes showing of the costs necessary to provide service under its proposed rates, it has established a *prima facie* case, and the burden then shifts to others to show that the costs incurred by the utility are unreasonable because of inefficiency or bad faith. [citations omitted] The fact that the People presented its testimony alleging Edison's construction program was unreasonable before Edison presented evidence rebutting those allegations was simply a reflection of the standard legal presumption of reasonableness on the part of the utility's management. (See also Ill. Rev. Stat. 1983, ch. 111-2/3, par. 64 ("no informality in any proceeding or in the manner of taking testimony * * * shall invalidate any order * * * by the Commission").) (City of Chicago v. Commerce Commission, 133 Ill. App. 3d 435, 442-43 (1st Dist. 1985))

This is the sequence of events that was followed in this case. Staff may think data request responses should be as comprehensive as prepared testimony, but this is an

unrealistic expectation, particularly when the utility is responding to in excess of 197 data requests on a variety of topics, and Staff is requesting that they be responded to in two weeks or less (a request that Mr. Lounsberry testified was complied with in this case (Tr. 198)). As noted above, in responding to Staff's data requests prior to submission of Staff's direct testimony, IP does not know what areas Staff will ultimately consider important. Other than as a rhetorical device, there is no basis for Staff to complain that data request answers are not as extensive as the rebuttal testimony that is prepared on a particular topic once Staff has identified it as an issue in the case. The ultimate issue, however, and the one the Commission should not lose sight of, is whether the totality of the evidence submitted in this docket in fact demonstrates that retirement of the Freeburg and Gillespie facilities were reasonable and prudent. Illinois Power submits that it does.

A. Capital Expenditures – PVRR Analyses (Response to §III.C. 1 of Staff's Initial Brief)

Replacement FT Costs. As noted earlier in this brief, Staff, in its Initial Brief, accepts some of the adjustments that IP made to Staff's PVRR analysis of retiring versus continuing to operate the Freeburg propane plant. However, Staff continues to dispute other adjustments to the PVRR analysis. The first adjustment Staff disputes in its brief is the use of replacement pipeline FT costs for the five winter months only, rather than for all 12 months. (Staff Init. Br., pp. 8-9) It is noteworthy that Staff does not dispute the Company's position that it would *not be necessary* to purchase replacement FT capacity equal to the full capacity of the Freeburg plant for the *entire year*, but only for the five winter months, since Freeburg was used to provide assurance of supply on the most severely cold winter days. (See IP Init. Br., pp. 11, 12) Therefore, the annual FT cost

figure used by Staff in its PVRR analyses ($1,273,000) is clearly overstated; the only question is by how much.[9]

Staff's criticism of the value IP used ($588,126) is that it is not based on any contracts IP has signed and does not reflect the fact that winter service comes at a premium.[10] (Staff Init. Br., p. 9) However, as IP witness Frank Starbody explained, the $588,126 value used by the Company was specifically based on the current tariffed FT rate premium on Natural Gas Pipeline Company for FT reservation in the winter months over the summer months, 20%. He testified that "While in the past Illinois Power has found it difficult to economically lease pipeline capacity on less than a 12-month basis, the market has evolved such that it is now more economical to purchase FT for the winter season (November through March) only, albeit at a price premium over summer season (April through October) rates." (IP Ex. 3.5, pp. 5-6) Both Staff's persistence in using the cost for a 12 month FT contract when a five-month contract would do, and its criticism of the specific winter FT cost used by IP, are without merit.[11]

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[9] Moreover, since the Freeburg propane plant was only maintained to provide winter peaking capacity on the most severely cold winter days, and typically operated no more than three days in a season (see IP Init. Br., pp. 3-4), there would be additional economic benefit to IP and its customers, beyond the mere replacement of the Freeburg plant's capacity, in acquiring an FT contract of equivalent capacity that would be available to be used 365 days per year. Staff's analysis gave no credit for this additional value in the "retire Freeburg" scenario.

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[10] Staff conducted no cross-examination on the basis for Mr. Starbody's calculation of the $588,126 figure. If Staff in fact had identified errors in this calculation, Staff would have demonstrated them through cross-examination.

[11] Staff also complains that the Company did not dispute Staff's replacement cost figure till IP's surrebuttal testimony. (Staff Init. Br., pp. 9-10) However, since Staff presented its PVRR analyses for the first time in its rebuttal testimony, surrebuttal was IP's first and only opportunity to dispute the replacement FT assumption Staff used in that analysis. Staff's related complaint that IP's surrebuttal testimony was filed only two days before the evidentiary hearings in this case (Id.) is a red herring; this procedural schedule was

The replacement FT cost assumption is important in analyzing the retirement of Freeburg, for two reasons. First, Staff acknowledges that based on Staff's acceptance of a number of the Company's adjustments to the PVRR analyses, the PVRR costs to continue to operate Freeburg of $5,630,160 for 30 years and $4,616,201 for 15 years, while somewhat overstated, most closely correspond to Staff's position. (Staff Init. Br., pp. 13-14) Staff contends that these PVRR values to continue to operate Freeburg are still less expensive than the amounts Staff calculated for replacement gas costs ($10,989,578 for 30 years and $8,056,872 for 15 years, see Id.) However, Staff's replacement FT costs represent the PVRR costs for a 12-month FT contract of equivalent capacity to the Freeburg facility, $1,273,000. Using the costs to purchase replacement FT contracts for only the five winter months results in PVRR values for replacement gas costs of $5,297,160 for 30 years and $3,942,249 for 15 years. (IP Ex. 3.6, pp. 7-8) These PVRR values are *less* that than PVRR values to continue to operate Freeburg that Staff finds reasonably accurate. Thus, even accepting Staff's position on all other disputed assumptions, use of the five month rather than the 12 month pipeline FT cost figure changes the outcome of the PVRR comparison.[12]

Second, the replacement FT cost assumption vividly illustrates the danger of basing the decision to expend substantial capital dollars to continue to operate the 30-year

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agreed to by the parties and approved by the ALJ at the April 26, 2001 prehearing conference (Tr. 5-7), so Staff has no basis to complain at this point that it was prejudiced by the short time period between surrebuttal testimony and the hearing.

[12] At a minimum, Staff should accept the PVRR analyses that assume replacement FT capacity can be purchased for just the five winter months as sensitivity analyses. This would be consistent with the Hillsboro least-cost plan and certificate cases cited by Staff, where IP presented multiple analyses with alternative scenarios to test the sensitivity of the economic study results to changes in key parameters. (See Orders in Docket 91-0024, p. 42, and 91-0499, pp. 8-9)

old Freeburg plant on a PVRR analysis whose results are dependent on the accuracy of the input assumptions over the next 30 years. As Mr. Starbody testified, the market has evolved with respect to the availability of pipeline FT capacity on a winter-season only basis; the availability of winter-season only FT on an economical basis was less clear in April 2000 (when IP decided to retire the Freeburg facility) than it had become by 2001. (IP Ex. 3.6, p. 9) As he pointed out:

> I believe this evolution illustrates one of the problems with relying on a long-term PVRR analysis to make the decision to upgrade and continue to operate Freeburg, as Mr. Lounsberry asserts. If in April 2000 we had performed the analysis Mr. Lounsberry has presented, and relied on it as the basis for our decision, we would have committed to over $1.8 million of capital expenditures on the assumption that our best alternative was to incur $1,273,000 in annual costs for FT to replace the capacity of the propane plant. Within a year, it would have become clear that our best alternative was less than $600,000 per year for replacement FT, yet the capital expenditures already would have been incurred. Further, based on the continuing evolution of the market, other alternatives, such as pipeline leased storage service, could have become economically attractive. (IP Ex. 3.6, p. 9)

In other words, if IP in April of 2001 had performed the PVRR analysis that Staff presented in this case, and relied on it to spend $1,873,000 on renovations and upgrades to the Freeburg facility in order to continue to operate it, the Company would have been (in Staff's view) "prudent" – but it also would have made an uneconomic decision, and saddled customers with the obligation to pay for this capital investment over the ensuing 15 to 30 years when there were less costly alternatives.

In the section of its Initial Brief on replacement gas costs (pp. 8-9), Staff also takes issue with IP's demonstration that any disallowance of replacement FT costs for the 2000 reconciliation year due to retirement of the Freeburg propane plant should be only $954,750, not the annualized value of $1,273,000, because the Freeburg plant was not

retired until April 2001.[13] Staff speculates that IP may have purchased an annual replacement service for Freeburg "during the prior reconciliation period because it already knew the facility was to be retired."[14] (Id., p. 9) However, Mr. Starbody clearly testified that:

> [T]he Freeburg propane plant was available for service in the winter of 1999-2000. It was not retired until after the conclusion of the 1999-2000 winter season. *IP did not begin to incur replacement FT costs until at least April 2000.* (IP Ex. 3.6, p. 15; emphasis supplied)

Thus, there is no basis to reject the Company's showing that FT costs to replace the Freeburg facility were not incurred until after the 1999-2000 winter season.[15] If IP did in fact buy a "replacement" annual FT contract for Freeburg in 1999 (which it did not), then the Company might be viewed as having some "excess capacity" during the first three months of 2000, but that "excess capacity" would not be due to the "imprudent" retirement of the Freeburg facility (because it was still in service), but rather to some other act of imprudence, which Staff has not identified, in purchasing the "excess" FT capacity. Further, Staff's speculative argument on this point overlooks the fact that in the proceeding for the "prior reconciliation period", 1999:

> Mr. Eric Lounsberry of the Engineering Department of the Commission's Energy Division stated that Staff reviewed IP's filing and the Company's responses to numerous data requests concerning the prudence of IP's gas purchases during the reconciliation period. He indicated that Staff found no reason to dispute IP's assertion that all its gas supply purchases during

[13] IP acknowledges that it missed this error in Staff's quantification in rebuttal testimony, and did not identify it until surrebuttal testimony. However, the issue for the ALJ and the Commission is, what quantification (if any) is correct based on the record.

[14] Again, Staff did not cross-examine Mr. Starbody on this point.

[15] If the Commission, for quantification purposes, were to treat Freeburg as having been "retired" on January 1, 2000, than IP would reiterate that the appropriate replacement gas cost figure is the cost of purchasing an equivalent amount of replacement FT capacity for the five winter months, $588,126.

> that period were prudently incurred. (Order in Docket 99-0477 (May 23, 2001), p. 4)

Thus, the end result of Staff's speculative argument would be to have the Commission disallow gas supply costs incurred by IP in 2000 as a result of procurement decisions made in 1999 that Staff (and the Commission) accepted as prudent!

Costs to Upgrade the Freeburg Propane Facility. In this section of its Initial Brief (pp. 10-11), Staff responds to the PVRR analysis presented by the Company which, based on the report of Dr. Ogle of Packer Engineering, used $2,500,000 as the renovation cost for the Freeburg facility. However, as can be seen from §II.B of IP's Initial Brief, the Company treats as the base case the PVRR analysis that used IP's original capital cost figure of $1,873,000, a figure Staff did not dispute.[16] (Tr. 36) IP presented the PVRR analysis using the $2,500,000 capital cost as an additional analysis to show the impact of plausible higher renovation and upgrade costs on the economics of continuing to operate the Freeburg plant. As a comparison of the results from the base case and those from the additional analysis (summarized at IP Ex. 3.6, pp. 7-9) shows, the higher capital costs (by $637,000 over the base case) increase the PVRR advantage for retiring Freeburg by over $1.2 million in the 15-year study and by over $1.3 million in the 30-year study.

Staff dismisses any likelihood that it could be necessary to install additional fire protection systems at the Freeburg propane plant (estimated by Dr. Ogle to cost $500,000 (Rev. IP Ex. 4.3, p. 4)), based solely on the assertion that "IP has operated this facility for

[16] Staff now acknowledges that the $1,873,000 figure is understated, as Staff agrees engineering documents should be updated (estimated by Dr. Ogle to cost $30,000) and that a comprehensive inspection of the 800,000 gallon refrigerated propane storage vessel should be conducted (estimated by Dr. Ogle to cost $75,000). (Staff Init. Br., p. 10) Of course, the comprehensive inspection could identify the need to incur additional costs for renovations and repairs before operations can be continued.

30 years without the need for this equipment and there is no requirement for it."[17] (Staff Init. Br., p. 11) However, the possible need for this equipment must be given some weight, *particularly in an analysis that assumes the plant will operate for another 30 years*. As Dr. Ogle's report explained:

> The current fire protection systems and procedures for the Freeburg facility are adequate only for small fires controllable by on-site personnel. In the event of a serious fire that could lead to a BLEVE [boiling liquid expanding vapor explosion], the Freeburg facility is not adequately protected. (Rev. IP Ex. 4.3, p. 3)

Staff's assertion that "there is no requirement for" additional fire protection equipment is contrary to the record. As Mr. Starbody testified, in considering whether to retire the Freeburg propane plant, the Company was concerned "that regulatory requirements applicable to these facilities could become more strict, which raised a concern that even the substantial expenditures that would have been necessary to renovate the propane plant could prove to be insufficient within a few years." (Rev. IP Ex. 3.2, p. 2) He explained that much of the equipment was installed in 1971 and is "grandfathered" from more recent requirements of codes and standards, such as NFPA 59; however, if IP were to undertake a major upgrade of the facility (which IP and Staff agree would have been needed in order to continue operating Freeburg), it could become subject to newer code requirements. This is a common situation in the application of industry codes and standards. (Tr. 127-28, 132-33)

Additional Future Capital Expenditures and O&M Costs (Inflation Rate). Staff concedes that the 15- and 30-year PVRR analysis should include provision for

[17] Staff characterizes this equipment as "$500,000 fire monitors" (Staff Init. Br., p. 11) In fact the cost estimate includes permanently fixed hose streams capable of delivering up to 5,000 gallons of water per minute for up to one hour, including fire pumps, piping, back-up power supplies for the pumps, and an on-site water supply. (Rev. IP Ex. 4.3, p. 3)

future capital additions to the Freeburg facility, but contends that IP's assumptions for future capital additions were excessive and not supported. (Staff Init. Br., pp. 11-12) However, Staff focuses solely on the capital improvement costs that have been required on the plant in recent years, and ignores the specific replacement and upgrade items which IP had identified were needed if the plant were to continue in operation. These included replacement of the heater and vaporizers (the existing heater and vaporizers are original equipment installed in 1971), replacement of the condenser and cooling fan, replacement of the collector tank, insulation of the 90,000 gallon transfer tank into which propane is initially loaded from transport trucks before being transferred into the 800,000 gallon storage vessel, and replacement of and upgrades to valves and piping.[18] (IP Ex. 3.6, p. 6) In addition to these specifically-identified projects, there is the possibility that additional fire protection equipment would be required (if not installed prior to further operation of the facility), and that the 800,000 gallon propane storage vessel could need significant repairs or replacement. As Packer Engineering's report stated:

> The vessel in question is 30 years old. There is a lack of inspection or test data to address the integrity of the storage vessel. This is not uncommon for a storage vessel in this type of service. However, *there is evidence of corrosion of the vessel wall due to water trapped between the vessel and its exterior insulation*. Therefore, prior to further service, it is recommended that the vessel be tested to determine whether corrosion has significantly degraded the wall thickness of the vessel. *Our estimates of expected corrosion rates indicate that the expected operating life of the vessel may have been exceeded* and that repairs or replacement of the vessel may be necessary. (Rev. IP Ex. 4.3, p. 3)

[18] These projects are in addition to those that would have been required in 2000 (listed on IP Exhibit 3.3), at a cost of $1,873,000, for the propane plant to continue to operate. (IP Ex. 3.6, p. 6)

As Dr. Ogle explained, some corrosion was already discovered in 1996, necessitating repairs.[19] (Tr. 161)

Of course, beyond the renovations and upgrades identified as needed in the near term (described above), IP did not and could not identify all of the specific capital improvement projects that would be needed throughout the next 30 years of operation of the Freeburg propane plant. However, it would be unreasonable to assume (as Staff did in the PVRR analyses it presented in this case) that a facility of this type that is already 30 years old could continue to operate for another 30 years without the need for significant, periodic additional renovations, upgrades, replacements and repairs.[20] Similarly, it would be unreasonable to assume (as Staff did) that real O &M costs for the propane facility would not increase over the ensuing 30 years of operation, as the propane plant continues to age.[21] (IP Ex. 3.6, p. 4)

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[19] Packer Engineering also identified two other bodies of regulations that could potentially be applicable to the Freeburg plant in the future, the OSHA Process Safety Management regulations and the U.S. EPA Risk Management Program regulations. Both sets of regulations apply to facilities that handle large quantities of flammable gases, and require development of extensive safety programs and documentation. Should the Freeburg facility become subject to these regulations, the cost impact could be substantial. (Rev. IP Ex. 4.3, p. 4)

[20] Although IP believes that the assumption it used for future capital additions is reasonable and not overstated, IP acknowledges that the impact of this assumption on the overall PVRR results tends to diminish in the later years of the 15 and 30-year PVRR analyses. As Mr. Lounsberry testified, the impact of the discount factor in the PVRR analysis tends to diminish the impact of costs more than 5 or 6 years into the future on the PVRR results. (Tr. 60) On the other hand, it must be kept in mind that if the Company were to operate Freeburg for another 30 years, ratepayers in those later years would pay for the additional capital expenditures and the higher O&M costs. The fact that the PVRR for continuing to operate Freeburg was low in 2000 or 2001 may be of little comfort to customers in 2010.

[21] Indeed, although IP acknowledges that Staff used an inflation forecast in its PVRR analyses that was taken from a well-known external source, one must view with some

Staff now claims, for the first time, that it "overstated" the annual O&M amount for the Freeburg facility in its PVRR analyses, and that this overstatement "provides some leeway for future capital expenditures. (Staff Init. Br., pp. 12, 13) This is a post hoc justification for Staff's failure to include adequate amounts of capital additions cost in its analysis, since the starting amount of O&M expense was not disputed between the parties at the hearing.[22] More importantly, Staff's purported "overstatement" of the initial O&M expense level does not address IP's criticisms of Staff's PVRR analyses, for two reasons. First, O & M expenses are not capital additions; they are accounted for differently and reflected in the revenue requirement calculation differently. Therefore, the actual impact on the PVRR results of Staff's "overstatement" of O&M expenses and understatement of capital additions is indeterminate. Second, the fact that O&M expenses are somewhat overstated at the outset does not really address the issue of whether real O&M expenses can be expected to increase over the ensuing 30-year period.

PVRR Conclusion. Staff states that the PVRR values for continued operation of the Freeburg facility of $5,630,160 in the 30-year study and $4,616,201 in the 15-year

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skepticism the assumption that the general rate of price inflation will remain at the low level of 2.85% per year for the next 30 years. (Staff Init. Br., p. 13) At a minimum, IP's assumption that O&M costs for the Freeburg plant will increase at an annual rate one percentage point above the inflation rate can be viewed as a plausible sensitivity that inflation for the next 30 years will be at a still-low rate of 3.85% per year.

[22] Staff's assertion that it overstated O&M expenses for the Freeburg facility in its PVRR analysis is based on the fact that the amount of O&M expense Staff assumed is greater than the amount of O&M expense for the facility in any of the years 1998-2000 as reported in IP's response to Staff data request ENG 2.186. (Staff Init. Br., pp. 12-13) However, in addition to the O&M dollars recorded for the propane plant, the Freeburg plant was monitored and inspected daily by Freeburg Storage Field personnel whose costs were charged to storage O&M expense, not to O&M for the propane plant. (See proposed Rev. Staff Cross Ex. 7 attached to IP's Motion to Correct Record) It was for this reason that IP accepted Staff's assumption of total annual propane plant O&M of $35,000 as a reasonable assumption.

study best approximate the results using assumptions for this scenario that Staff believes to be reasonable. (Staff Init. Br., pp. 13-14) However, as noted earlier in this reply brief, the PVRR values for retirement of the Freeburg plant and acquisition of replacement pipeline FT capacity for the five winter season months only are $5,297,160 in the 30-year study and $3,942,249 in the 15-year study – in each case lower than the PVRR for continued operation of the Freeburg plant. (See IP Ex. 3.6, pp. 7-8, and IP Exs. 3.8 and 3.10) Therefore, based on the record, the Commission should conclude that retiring the Freeburg propane plant was economically justified.

B. Residential Development/Plant Safety (Response to §III.C. 2 of Staff's Initial Brief)

Staff's position regarding the trend of development in the area around the Freeburg propane plant ignores the totality of the evidence. The record, when viewed in its entirety, demonstrates that the trend of development towards and around the plant site is a legitimate concern that supports the reasonableness of the retirement of the Freeburg facility – *particularly* when Staff's principal argument against retirement is a PVRR study that assumes the propane plant would be operated for another 15 to 30 years.

As IP witness Mr. Starbody testified, in deciding to retire the Freeburg plant, IP was concerned both with the growth and development that had occurred in the Freeburg area over the past 30 years, and with the likelihood that development would continue to move closer to the site over the 10-15 additional years IP would need to operate the facility in order to justify the $1,873,000 of capital expenditures that would have been needed in 2000. (IP Ex. 3.6, p. 12; Tr. 122) Staff, in its Initial Brief, does not dispute the facts (testified to by Mr. Starbody) that there has been considerable growth in the populations of the two closest communities, Freeburg and Smithton, since 1971; that the

popularity of the area as a "bedroom" community for St. Louis and for developing areas of the Metro East area has also increased over the years; that the Freeburg-Smithton area is reasonable commuting distance from both St. Louis and commercial areas in the Metro East area; that the area extending south of Freeburg to within about 1.5 miles of the propane plant site has recently been rezoned from farmland to commercial; that the highway running from the town of Freeburg to and past the plant site has recently been widened and resurfaced; that there are already 27 homes on the road from the plant site to Smithton, including 16 within two miles of the plant site, many of which have been constructed in the last few years; or any of the other evidence that demonstrates the vicinity has been developing rapidly and is likely to continue to develop. (IP Ex. 3.6, p. 11; Tr. 79, 84-85, 123) What is happening here is consistent with what is happening in numerous other major metropolitan areas, including both Chicago and St. Louis: residential and commercial development and expansion are continuing to move outward from the traditional metropolitan area into what were formerly rural, farming areas. Common experience and common sense should indicate that these trends will continue.

Instead, Staff focuses on the fact that "the closest new residential development is approximately 4.3 miles away from the facility", that "there is no newly developed dense residential development closer than four miles to the facility", and that Staff witness Lounsberry's "personal observation" was that "the nearest residential development was over 4 miles away." (Staff Init. Br., pp. 14, 15, 16) Staff concludes that this is far enough away to pose no safety concern by asserting that, according to Dr. Ogle's report, a propane explosion at the 800,000 gallon storage vessel would destroy residential and

commercial structures within 1.2 miles, break windows within 1.75 miles, and cause second degree burns to persons within 1.75 miles. (Id., p. 16)

Mr. Lounsberry's "personal observation", however, was incredibly myopic. For example, the aerial photograph of the area placed into evidence by Staff, taken over four years ago (Staff Cross Ex. 1), clearly shows a substantial number of homes within about 2 to 2.5 miles of the plant site to the north and northeast.[23] Further, as Dr. Ogle's report cautioned in reporting the predicted impacts of a propane explosion at the storage vessel:

> Predictions of the fire and explosion damage caused by an accident such as this contain some uncertainty. The reported distance from the facility to the nearest community (2.5 miles) is not a sufficient buffer zone distance to protect these residents from injury and/or property damage. (Rev. IP Ex. 4.3, p. 2)

Staff's focus on the "closest new residential development . . . 4.3 miles away" fails to give adequate consideration to the residences and businesses located about 2.5 miles from the propane plant site to the north and northeast, the 27 residences located between the plant site and the "nearest residential development", and the plant employees and emergency response personnel, who, as Dr. Ogle testified, are the persons most at risk and exposed to injury or death in the event of propane explosions or fires. (Tr. 175)

Staff dismisses the possibility of a catastrophic explosion or fire at the propane plant because (1) of the five such accidents noted in Packer Engineering's report, only two occurred in the U.S., and one involved derailment of a propane tank car, and (2) the Freeburg plant operated safely and reliably, with only a few incidents, over the last 30 years. (Staff Init. Br., pp. 17-18) However, as noted in IP's Initial Brief, both rail cars

[23] The aerial photograph (Staff Cross Ex. 1) includes a scale and is marked to show a one-mile radius around the plant site.

and transport trucks are options for delivering propane to the Freeburg plant.[24] Once at the plant site, the propane must be offloaded from the transportation medium into a 90,000 gallon transfer tank and then further transferred into the 800,000 gallon refrigerated sphere. (IP Ex. 3.6, p. 6) The need to transfer and handle these volumes of propane presents additional risks beyond those presented by the possibility of leaks in the storage vessel itself. Further, the need to transport propane in numerous transport trucks or railcars through the surrounding area to the plant site increases the scope of the area exposed to potential damage from a propane accident.

Staff's assertion that "the issue is whether or not safety was a legitimate concern when the Freeburg facility was retired" (Staff Init. Br., p. 18) is incorrect; rather, the issue is whether, based on the record before the Commission, retirement of the Freeburg facility is a reasonable and prudent decision. Staff's assertion that safety is not a legitimate concern in the decision to retire the plant because "eighteen months after IP made its decision to retire the facility it retained [Packer Engineering] to help justify that decision" and "IP never had access to Dr. Ogle's report when making its initial decision" (Id.) is baseless. As Mr. Starbody testified in his rebuttal testimony – which was submitted even before Packer Engineering was hired – safety issues were a fundamental concern in IP's decision to retire the propane plant. (See Rev. IP Ex. 3.2, pp. 2-5) Dr. Ogle's report merely confirmed IP's concerns. Illinois Power did not have to hire Packer Engineering to learn that safety was a legitimate concern. Rather, IP hired Packer Engineering because Staff would not accept the testimony of a Company employee that

[24] The equivalent of 90 transport truck deliveries is required to refill the 800,000 gallon storage vessel; this provides enough inventory for only three days of operation. (IP Ex. 3.6, pp. 12-13)

safety was a legitimate concern, and so therefore it was necessary to obtain the analysis of an independent expert for purposes of this proceeding.

Staff's argument that "if it operated OK for the last 30 years, it will operate OK for another 30 years" is similar to believing that if one's 10-year old car has operated reliably for the last ten years, it will operate just as reliably for the next ten years (and, according to Staff, with no real increase in maintenance costs). Staff's argument is unreasonable. In deciding to retire the Freeburg plant, Illinois Power realized that as mechanical equipment and pressure vessels continue to age, they will either operate less reliably, and/or will cost increasingly more to maintain at the prior levels of safety and reliability. (Rev. IP Ex. 3.2, p. 4; IP Ex. 3.6, pp. 13-14) Further, no amount of expenditures will make the 10-year old car or the 30-year old propane facility new again.

Staff also contends that the need to maintain an operator training program for the Freeburg propane plant cannot have been a valid reason supporting retirement of the facility. (Staff Init. Br., pp. 19-20) Staff overlooks the fact that while the Company had once maintained an operator training program for five propane plants, by 2000 it was maintaining a training program for only one plant. Further, Packer Engineering identified a need for IP to develop a new operator training program for the propane plant and to increase its expenditures on operator training. (Rev. IP Ex. 4.3, pp. 3-4)

Staff further argues that safety and reliability are not valid concerns because upgrading and renovating the propane plant should maintain, if not improve, its safety and reliability. (Staff Init. Br., pp. 18, 20) IP agrees in principle that increased expenditures on improved safety systems, renovations and upgrades, and increased O&M, can reduce the extent to which safety concerns and the possibility of unreliable

operation are considered risks.[25] For example, complete replacement of the 800,000 gallon refrigerated propane storage vessel (a cost which neither party's PVRR analyses expressly accounted for) could reduce the concern over the risk of an explosion or fire due to a leak in this 30-year old pressure vessel, which may be experiencing corrosion and may have exceed its expected operating life. (Rev. IP Ex. 4.3, p. 3; Tr. 160-62) However, as discussed in IP's Initial Brief and earlier in this Reply Brief, Staff's PVRR analyses have understated the level of renovation and upgrade costs and O&M costs that can reasonably be expected to be needed for safe and reliable operation if the facility is to be operated for another 15 to 30 years. Staff cannot have it both ways – Staff cannot understate ongoing capital expenditure and O&M requirements in its PVRR analysis and then contend that upgrading and renovating the plant should remove safety and reliability as concerns.[26] The PVRR analyses that Illinois Power presented assume levels of ongoing capital expenditures and O&M costs necessary for continued safe and reliable operation. However, *they also show that continued operation is not economic.*

Staff's approach of analyzing in isolation, and rejecting, each factor considered by the Company in deciding to retire the Freeburg propane plant does not integrate all the relevant information that went into this decision. In 1971, propane plants were a reasonable and necessary part of IP's overall winter supply portfolio, in light of supply

[25] However, even if the possibility of a catastrophic propane accident is considered extremely low, either because of a high level of capital and O&M expenditures on the facility to maintain safety, or because such accidents happen infrequently in industry (see Staff Init. Br., p. 19), prudent decisionmaking must take into account the consequences of such an accident if one did happen, not dismiss it as an impossibility that can't happen.

[26] As discussed in §III.A of this Reply Brief and at IP Ex. 3.6, p. 6, the $1,873,000 of upgrades and renovations that were needed in 2000 (listed on IP Ex. 3.3) were just the first items in a long list of equipment upgrades, renovations and replacements that would be needed if the Freeburg facility were to continue in operation.

conditions and the state of development of interstate pipeline infrastructure; the Freeburg propane plant was new; the Company operated a total of five propane facilities; and the Freeburg area was much less developed. Today, the Freeburg propane plant is 30 years old and has shown evidence of deterioration in many components; it is the only remaining propane plant on IP's system; the Freeburg area is more heavily developed and all indications point to continuation of that development; and propane plants are no longer vital to insuring winter supply reliability within IP's service area – pipeline FT capacity (which is available for use on every day of the contract period) offers substantial advantages in terms of safety, reliability, lower risk and convenience. (See Rev. IP Ex. 3.2, p. 4; IP Ex. 3.6, p. 14) Consideration of all the relevant factors shows that the retirement of the Freeburg propane plant was prudent, reasonable and appropriate. Staff's arguments to the contrary must be rejected.

IV. RETIREMENT OF GILLESPIE STORAGE FIELD (Response to §III.D of Staff's Initial Brief)

Adjustment Amount. Staff persists in its speculative assertion that Illinois Power incurred excess gas commodity costs during a six-day period in December 2000 because it would have withdrawn gas from the Gillespie Storage Field during this period had the Field been in service, and thus instead had to use higher-priced gas from other sources. (Staff Init. Br., pp. 22-23) The record does not support Staff's hypothesis.

Staff contends that the December 17-22 period was "unique from any past experience" because the Hillsboro Storage Field was out of service. (Staff Init. Br., pp. 22-23) (Id., p. 22) The unavailability of the Hillsboro Field during this period may have been "unique", but the facts show that circumstances were not so unusual that they would have caused IP to depart from its normal practice of not withdrawing Gillespie's

inventory that early in the heating season, but rather conserving that inventory till later in the season. (Rev. IP Ex. 3.2, pp. 9-10; see IP Init. Br., p. 23) The December 17-22 period was not particularly cold, with the non-transportation load on the coldest day of the period equal to only about 78% of that expected on a design peak day. (Rev. IP Ex. 3.2, p. 10; IP Ex. 3.6, p. 22) More significantly, even without the Hillsboro Field, IP's utilization of its available storage field capacity ranged from only 31% to only 54% on December 17-21, and was only 33% on December 22 when the Hillsboro Field returned to partial availability. (Id.) In fact, the only thing "unique" about the December 17-22 period was that due to abnormally cold weather that had already occurred, and unusually high spot gas prices, in November and December, IP had drawn down its storage field inventories more than would usually have been the case by mid-December. (IP Ex. 3.1, p. 7; Rev. IP Ex. 3.2, p. 9) By mid-December, therefore, the Company was being particularly cautious about hoarding its storage inventories in order to ensure adequate supplies during the remainder of the winter heating season.

Staff cites the fact that during the December 17-22 period, IP scheduled injections into some of its storage (Staff Init. Br., p. 23; see Staff Cross Ex. 11 and Tr. 52), but Staff draws the wrong inference from this fact. The fact that IP was injecting gas to storage during the December 17-22 period confirms that the Company did not need to fully utilize its storage capacity to serve load during this period. If the Company had needed to fully utilize its storage, including Gillespie, to serve load, it would not have been injecting gas into storage during this period. Accordingly, any disallowance in this case in respect of the retirement of the Gillespie Storage Field should not include the commodity cost component developed by Staff.

Upgrade Costs. Staff continues to dispute Illinois Power's estimate of the costs to renovate the Gillespie Field compressor station, which was based on the cost actually incurred by Illinois Power to repair the South Shanghai compressor station in 1995, on the grounds that the Shanghai Storage Field is a much larger storage field than was Gillespie and thus the renovations at Gillespie cannot have cost as much. (Staff Init. Br., pp. 23-24) Staff continues to cite the larger size of the Shanghai Field and the additional facilities and equipment at the Shanghai Field that were not present at the Gillespie Field. (Id.) These comparisons are not meaningful to the issue at hand. IP did not need to renovate and upgrade the injection/withdrawal wells, the monitoring wells, the dehydration towers, the reboilers, the separators, the moisture analyzer, the supply pipelines and the injection/withdrawal meters at Gillespie (see Id., p. 24), and the cost of the 1995 work at South Shanghai used to estimate the Gillespie upgrade costs did not include repair or renovation of any such facilities at the Shanghai Field. Rather, IP renovated a single compressor station at South Shanghai in 1995, and appropriately used the cost of that work to estimate the cost of renovating a single compressor station at Gillespie in 2000.[27] (See Tr. 123-25 and Staff Cross Ex. 4)

PVRR Analyses. Staff agrees with IP that the PVRR analyses of retiring the Gillespie Field versus renovating the compressor station and continuing to operate the Field should include an allowance for future capital additions ($10,000 per year) and

[27] IP used the actual 1995 cost of the work done at South Shanghai as the cost of the work needed in 2000 at Gillespie, in its PVRR analyses that showed a lower PVRR to retire Gillespie and obtain replacement pipeline FT capacity than to incur the renovation costs and continue to operate Gillespie, over both 15 and 30-year study periods. (IP Ex.3.6, p. 19) IP also conducted additional PVRR analyses in which it escalated the actual 1995 cost to account for inflation from 1995 to 2000. These PVRR sensitivities showed an even larger PVRR advantage to retirement of the Gillespie Field. (Id., p. 20)

carrying costs on the storage gas inventory. (Staff Init. Br., p. 25) These components were not included in the PVRR analyses presented by Staff in this case. (See IP Ex. 3.6, pp. 18-19) Staff acknowledges that with these components, the 15-year PVRR analysis shows savings from retiring Gillespie, and the 30-year PRR analysis "is a virtual break-even proposition." (Staff Init. Br., p. 25) However, in making these concessions, Staff is referring to the PVRR analyses which assumed that if Gillespie were retired its capacity would be replaced by purchasing an equivalent amount of pipeline FT capacity on a year-round basis. For the reasons discussed in §III.A of this Reply Brief (concerning replacement of the Freeburg facility) and in §III.A of Illinois Power's Initial Brief, it would not have been necessary to obtain replacement FT capacity on a year-round basis to replace Gillespie. Rather, it only would have been necessary to purchase replacement FT capacity for the five winter season months, at an estimated cost of $147,000, rather than the $318,250 annualized cost used by Staff. (IP Ex. 3.6, p. 19) With the correct gas cost figure, the PVRR analyses show substantial PVRR savings for retirement of the Gillespie Field over upgrading the compressor station and continuing to operate the Field, in both the 15-year and 30-year studies. (See Id., pp. 19-20)

Operational Concerns. Staff contends that the operational concerns relating to the need to lower the pressure in the distribution system surrounding the Gillespie Field in order to make withdrawals from it were not valid because reduction of the pressure in the surrounding area required reduction of pressure at the Staunton regulator station, which is under automatic control and constantly monitored. (Staff Init. Br., p. 26) However, Staff ignores a critical fact: if the Gillespie compressor station were to fail or trip off line while the pressure was reduced in the surrounding distribution system, IP's

operators would not be able to restore the pressure in the distribution system quickly enough to prevent service outages. (IP Ex. 3.6, p. 21) Thus, the operational concerns relating to withdrawals from the Gillespie Storage Field were valid, and provided an additional reason supporting the decision to retire the Field.

V. GAS PURCHASING ACTIVITY (Response to §III.E of Staff's Initial Brief)

Staff contends that the Company was imprudent in basing its decisions on which firm supply reservation contracts to enter into solely on the lowest reservation costs among the competing offers, without also taking into account the commodity prices in these offers (even though IP is not obligated to buy any gas under these contracts). (Staff Init. Br., pp. 27-28) However, as IP demonstrated, the accuracy and reliability of any attempt to quantify the amount of gas commodity that will actually be purchased under any of these contracts would be completely overwhelmed by the uncertainty of the assumption that went into it. (Rev. IP Ex. 3.2, pp. 13-14; IP Ex. 3.6, pp. 25-26)

Staff expresses disagreement with IP's position, and asserts that the Company "attempts to overly complicate the analysis." (Staff Init. Br., pp. 27-28) Staff contends that IP should calculate the "break-even load factor" for each firm supply reservation contract, i.e., the amount of gas commodity to be taken under a swing contract above which it would be lower cost to select a different contract with a higher fixed daily reservation fee but a lower commodity price applicable to any gas actually taken. (Id.) However, this exercise does not address the fundamental problem of trying to accurately forecast the amount of gas commodity that will in fact be purchased under each contract. Unless there is a basis for forecasting with reasonable accuracy the amount of gas commodity likely to be taken under each contract, this exercise will not contribute to

improved decisionmaking. In fact, it may result in erroneous decisionmaking and higher costs for customers. Staff has not, at any point in this case, proposed any method for estimating the amount of gas commodity that will actually be taken under each swing contract that would inspire any confidence in its accuracy or in the value of the exercise suggested by Staff.

Staff argues that in evaluating firm supply reservation contracts for the 2000-2001 winter, IP should have compared "break-even load factors" to the average load factor for the 16 such contracts entered into for the 1999-2000 winter (26.8%). Staff conveniently picks as an example a 2000-2001 swing contract that had a "break-even load factor" of 25%. (Staff Init. Br., p. 28) However, Staff fails to address the fact that while the average load factor for the 16 swing contracts in the winter of 1999-2000 was 26.8%, the load factors for the 16 individual contracts ranged from 15% to over 58%. (IP Ex. 3.6, p. 25) Staff also fails to address the fact that the average load factors on these contracts can change dramatically from year to year, due to a variety of factors. For example, the average load factor for the 18 firm supply reservation contracts entered into for the 2000-2001 season was 56.1% (more than twice the previous winter's average). (Id.) As Mr. Starbody noted, for the next winter, the load factor average could just as easily revert to a lower number. (Id., pp. 25-26) Further, in the 2000-2001 winter, although the average load factor for the 18 swing contracts was 56.1%, the individual load factors for these 18 contracts ranged from less than 1% to over 90%, and the values for the individual contracts were dispersed throughout this range. (Id., p. 25) In summary, the actual amounts of gas commodity that will be taken under individual firm supply reservation contracts are highly variable, and extremely difficult to forecast. (Rev. IP Ex. 3.2, p. 15)

Reliance on the prior year's average load factor, as suggested by Staff, could actually be a trap for the unwary, and lead to contracting decisions that result in higher costs for customers.

Staff's position on this issue continues to be revisionist history, and not based on any identified standards for prudent purchasing practices. As described in §IV of IP's Initial Brief, in the prior year's (1999) reconciliation case, IP described its practice of selecting winter firm supply reservation contracts based on lowest reservation cost, and Staff witness Mr. Lounsberry did not find this practice to be imprudent. In this case, for unexplained reasons, Mr. Lounsberry changed his position and asserted, in his direct testimony, that selecting these contracts based solely on lowest reservation fees was not prudent. (Staff Ex. 2.0, p. 19) Further, it was not until Mr. Lounsberry's rebuttal testimony that he contended that the prudent way to evaluate these contracts was to calculate the "break-even load factors" (see Staff Ex. 4.0, p. 23); and it was not until its Initial Brief that Staff contended that the "break-even load factors" should be compared to the actual average load factor for swing contracts experienced in the preceding winter.[28] (Staff Init. Br., p. 28) Staff's version of the prudent practices that Illinois Power should have followed in evaluating and entering into firm supply reservation contracts seems to have been a work in progress throughout this case! Staff's proposed

[28] IP witness Mr. Starbody had pointed out in his rebuttal testimony, in responding to Mr. Lounsberry's direct testimony, that Mr. Lounsberry had not presented any analysis depicting how IP should have taken the commodity prices in the firm supply reservation offers into account. (Rev. IP Ex. 3.2, p. 14)

gas cost disallowance related to the firm supply reservation contracts is unfounded and should be rejected.[29]

VI. CONCLUSION

For the reasons set forth in Illinois Power's Initial Brief and in this Reply Brief, the Commission should reject the adjustments to Illinois Power's 2000 reconciliation proposed by Staff. The Commission should adopt, without adjustment, the 2000 reconciliation presented by the Company in IP Exhibit 2.2.

Respectfully submitted,

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[29] As described in §V of IP's Initial Brief (pp. 29-30), Staff's proposed disallowance should be rejected for at least two other reasons. First, Staff's calculation is based on only two of 18 contracts and does not consider the savings IP realized on the other 16 contracts; in the aggregate, IP realized total savings of $16,815 during 2000 on these 18 contracts (all of which were selected on the basis of lowest reservation cost) versus the next best offer. Second, Staff's calculation of excess costs incurred on one of the two contracts is incomplete and, as a result, overstated.